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TAGS: ECON, OECD

SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF BENELUX, MAY 25, 1976

REF: EDR(76)10

1. SUMMARY: IN REFDOC CIRCULATED FOR EDRC REVIEW OF BENELUX, SECRETARIAT NOTES FOR BELGIUM THAT 1974-1975 RECESSION, WHICH WAS CHARACTERIZED BY 1.4 PERCENT DROP IN REAL GNP, HIGH INFLATION AND STRONG DETERIORATION IN LABOR MARKET, APPARENTLY BOTTOMED OUT IN EARLY 1976. SECRETARIAT FORECASTS 3.3 PERCENT GROWTH IN REAL BELGIAN GNP IN 1976, WITH PUBLIC INVESTMENT AND EXPORT GROWTH LEADING WAY. BELGIAN MONETARY AND FISCAL POLICY TURNED RESTRICTIVE IN EARLY 1976, REFLECTING NEED TO CONTROL INFLATION, CURB GOVERNMENT SPENDING AND TO HELP AVERT REPETITION OF SPECULATIVE PRESSURE ON BELGIAN FRANC. IN VIEW OF RISK THAT BELGIAN INFLATION RATE
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COULD EVEN EXCEED THE 10 PERCENT SECRETARIAT FORECAST,

SECRETARIAT ADVOCATES PRUDENT DEMAND MANAGEMENT STANCE DESPITE LIKELIHOOD THAT EMPLOYMENT SITUATION EXPECTED NOT TO IMPROVE OR EVEN TO WORSEN DURING YEAR. SECRETARIAT ALSO RECOMMENDS: (A) STRENGTHENING OF TAX SYSTEM TO HELP REDUCE PUBLIC-SECTOR DEFICIT; (B) EFFECTIVE IMPLEMENTATION OF RECENTLY-INSTITUTED WAGE/PRICE POLICIES; (C) COMBINATION OF SELECTIVE MEASURES TO REDUCE REGIONAL AND OTHER STRUCTURAL IMBALANCES IN LABOR MARKET, TOGETHER WITH INCREASED USE OF TEMPORARY PUBLIC SERVICE EMPLOYMENT AND WIDER COVERAGE OF UNEMPLOYMENT COMPENSATION. FOR LUXEMBOURG, SECRETARIAT FORECASTS 3 PERCENT GROWTH OF REAL GDP, 10 PERCENT INFLATION RATE AND LITTLE INCREASE IN EMPLOYMENT. EVOLUTION FOR 1976 OF BENELUX AS WHOLE WILL DEPEND CRUCIALLY ON GROWTH OF WORLD TRADE. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS/QUESTIONS WHICH COULD BE USEFULLY POSED DURING REVIEW. (NOTE: REPS FROM EMBASSY BRUSSELS WILL PARTICIPATE IN REVIEW.) END SUMMARY.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: SECRETARIAT ESTIMATES THAT BELGIAN REAL GNP FELL BY 1.4 PERCENT IN 1976. MOST DEMAND COMPONENTS WEAKER, WITH ONLY ELEMENTS OF SUPPORT BEING PRIVATE AND PUBLIC CONSUMPTION. AT THE SAME TIME, LABOR MARKET SHOWED STRONG DETERIORATION, WITH UNEMPLOYMENT RATE REACHING 8.7 PERCENT BY END OF YEAR, WHILE CONSUMER PRICES REGISTERED INCREASE OF 12.8 PERCENT. FOR 1976, SECRETARIAT PROJECTS 3.3 PERCENT GROWTH IN REAL GNP, WITH ENGINES OF GROWTH BEING 7.6 PERCENT INCREASE IN EXPORT VOLUMES; 0.6 PERCENT POSITIVE CONTRIBUTION TO GNP FROM STOCK MOVEMENTS (VS. NEGATIVE 2.6 PERCENT CONTRIBUTION IN 1975) AND STRONG GROWTH IN PUBLIC INVESTMENT. MORE DISQUIETING IS SECRETARIAT FORECAST OF 5.6 PERCENT DECLINE IN PRIVATE INVESTMENT, POSSIBLE DECLINE IN TOTAL EMPLOYMENT AND CONTINUED RAPID INCREASE IN CONSUMER PRICES (10 PERCENT).

3. ELABORATING FURTHER ON WAGE/PRICE OUTLOOK, SECRETARIAT NOTES THAT PRICE CONTROL PROGRAM WHICH WAS IMPLEMENTED AND GRADUALLY PHASED OUT DURING 1975 WAS RELATIVELY INEFFECTIVE IN CONTROLLING INFLATION RATE LAST LIMITED OFFICIAL USE

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YEAR. SECRETARIAT HAS HIGHER HOPES FOR NEW GOB INITIATIVE IMPLEMENTED IN MARCH 1976, WHICH AIMS BOTH AT RESTRAINING PRICE INCREASES DIRECTLY AND AT REDUCING COST PRESSURE BY LIMITING INDEXATION-LINKED WAGE INCREASES. HOWEVER, SECRETARIAT NOTES THAT PROGRAM IS TEMPORARY MEASURES TO EXPIRE AT END OF 1976), AND THAT IT WILL HAVE SUBSTANTIAL EFFECTS ONLY ON A LIMITED SECTOR OF THE WORKING POPULATION. FURTHERMORE, ALTHOUGH LIMITATIONS

ON INDEXED WAGE INCREASES WILL REDUCE LABOR COSTS OF FIRMS, SUBSTANTIAL PORTION OF REALIZED SAVINGS MUST BE PAID BY FIRMS INTO NEWLY-CREATED "SOLIDARITY FUND" WHICH WILL BE USED FOR PENSION PURPOSES. THUS, SECRETARIAT NOTES THAT ANTI-INFLATION IMPACT OF PROGRAM COULD BE REDUCED. SECRETARIAT NOTES THAT IT IS STILL TOO EARLY TO PASS JUDGMENT ON PROGRAM'S EFFECTIVENESS, BUT SEES

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RISK OF ACCELERATED INFLATION AS PROBLEM WHICH MUST REMAIN CENTRAL TO CONCERNS OF BELGIAN AUTHORITIES IN 1976 AND OVER THE MEDIUM TERM.

4. CURRENT ACCOUNT: CURRENT ACCOUNT SURPLUS INCREASED TO \$1.02 BILLION IN 1975 (FROM \$919 MILLION IN 1974), AS 8.8 PERCENT FALL IN EXPORT VOLUMES WAS MORE THAN OFFSET BY 10 PERCENT REDUCTION IN IMPORT VOLUMES. TAKING ACCOUNT OF THE PRESENT BRISK RECOVERY IN FRANCE AND IN FRG, SECRETARIAT EXPECTS BELGIAN EXPORT MARKETS TO GROW BY 11 PERCENT, AND PROJECTS 7.6 PERCENT GROWTH IN BELGIAN EXPORT VOLUMES. SECRETARIAT ATTRIBUTES LOSS IN MARKET

SHARES PRIMARILY TO FACT THAT PICK-UP OF DEMAND FOR INTERMEDIATE GOODS (WHICH CONSTITUTE SUBSTANTIAL PORTION OF BELGIAN EXPORTS) TENDS TO LAG RECOVERY OF OVERALL DEMAND DURING UPSWING. BELGIAN OFFICIAL PROJECTIONS ONLY SHOW 4.8 PERCENT GROWTH IN EXPORT VOLUMES IN 1976. SECRETARIAT FORECASTS 7.6 PERCENT INCREASE IN IMPORT VOLUMES COMPARED WITH BELGIAN ESTIMATE OF 5 PERCENT. LIMITED OFFICIAL USE

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THUS, WHILE BELGIANS AND SECRETARIAT EXPECT LITTLE CHANGE IN REAL FOREIGN BALANCE IN 1976, SECRETARIAT JUDGMENT THAT POSITIVE DOMESTIC MULTIPLIER EFFECTS OF EXPORT INCREASE WILL DOMINATE NEGATIVE EFFECTS OF IMPORT VOLUME INCREASE IS MAJOR REASON WHY SECRETARIAT FORECAST OF 1976 GNP GROWTH (3.3 PERCENT) EXCEEDS THAT OF BELGIAN AUTHORITIES (2.7 PERCENT).

5. SECRETARIAT DOES NOT COMMENT IN DETAIL ON DOWNWARD SPECULATIVE PRESSURE ON BELGIAN FRANC WHICH OCCURRED IN EARLY 1976, BUT NOTES THAT: (A) DEFENSE OF FRANC WAS EXPENSIVE (ABOUT \$3 BILLION); (B) WHILE DIRECT TARGET OF SPECULATION WAS NOT THE BELGIAN FRANC, PRUDENT DOMESTIC POLICIES AND REDUCTION IN INFLATION RATE WILL BE NECESSARY TO AVOID BELGIAN FRANC'S BEING ADVERSELY AFFECTED BY FUTURE OUTBREAKS OF SPECULATION.

6. FISCAL AND MONETARY POLICY: STANCE OF BOTH FISCAL AND MONETARY POLICY WERE EXPANSIONARY IN 1975 AND BECAME RELATIVELY RESTRICTIVE IN EARLY 1976. BASIC OBJECTIVE OF GOB IN 1976 IS TO REDUCE INFLATION RATE AND TO HELP SUPPORT FRANC. IN ADDITION, "SOBRIETY PLAN" IMPLEMENTED IN APRIL 1976 HAD FURTHER OBJECTIVE OF REDUCING THE PUBLIC FINANCING REQUIREMENT, WHICH ROSE TO 5 PERCENT OF GNP IN 1976 TO BRING TOTAL NOMINAL VALUE OF OUTSTANDING PUBLIC DEBT TO 42 PERCENT OF GNP. SECRETARIAT COMMENTS THAT MAGNITUDE OF OUTSTANDING DEBT ALREADY CONSTITUTES CONSTRAINT ON FISCAL POLICY, AND THAT MEASURES TO EFFECT ITS REDUCTION ARE IN ORDER.

7. RECOMMENDATIONS AND CONCLUSIONS: BASED ON ANALYSIS REFDON, SECRETARIAT SUGGESTS THAT EDRC REACH FOLLOWING CONCLUSIONS:

(A) IN VIEW OF NEED TO CONTROL INFLATION RATE (AND TO PROTECT FRANC), BELGIAN DEMAND MANAGEMENT POLICY SHOULD REMAIN PRUDENT IN 1976; RELIANCE SHOULD BE PLACED ON EXPORT GROWTH TO SUSTAIN RECOVERY;

(B) WHILE IT IS STILL TOO EARLY FULLY TO EVALUATE EFFECTIVENESS OF RECENT MEASURES TO LIMIT WAGE AND PRICE

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INCREASES, THERE IS A CLEAR NEED TO DEVELOP AN EFFECTIVE
AND DURABLE MECHANISM TO CONTROL COSTS AND PRICES SO AS
TO MAINTAIN BELGIAN COMPETITIVENESS INTERNATIONALLY AND

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TO MAINTAIN INFLOWS OF DIRECT INVESTMENT;

(C) THERE IS A CONTINUING NEED TO INCREASE PUBLIC
INVESTMENT SPENDING. TO ALLOW THIS TO TAKE PLACE WITH-
OUT INCREASING THE SIZE OF THE PUBLIC DEBT, IMPROVEMENTS
IN TAX SYSTEM AND REDUCTIONS OF DEFICIT ON CURRENT SPEND-
ING WILL BE NECESSARY;

(D) SELECTIVE MEASURES TO CORRECT REGIONAL AND STRUCTURAL IMBALANCES IN LABOR MARKET WOULD BE APPROPRIATE.

8. COMMENTS: (A) THERE IS A MAJOR DIFFERENCE BETWEEN SECRETARIAT AND BELGIAN PROJECTIONS OF GROWTH IN EXPORT AND IMPORT VOLUMES. MISSION WOULD QUESTION BELGIANS RE THEIR ASSUMPTIONS CONCERNING GROWTH OF EXPORT MARKETS, IMPORT ELASTICITIES WITH RESPECT TO GNP GROWTH AND RELATIVE PRICE DEVELOPMENTS; (B) MISSION ALSO PLANS TO ASK BELGIANS TO ELABORATE ON EFFECT OF 1975 PRICE CONTROL LIMITED OFFICIAL USE

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PROGRAM ON BUSINESS PROFITS AND ON THE EXPECTED EFFECT OF NEW PROGRAM ON SAME; (C) SECRETARIAT REFERS TO NEED TO INCREASE PUBLIC INVESTMENT, BUT DOES NOT EMPHASIZE NEED TO STIMULATE PRIVATE INVESTMENT, WHICH DECLINED IN 1975 AND IS EXPECTED TO FALL IN 1976. MISSION WOULD ASK SECRETARIAT TO EXPLAIN ITS FOCUS ON INCREASING PUBLIC INVESTMENT AND WOULD QUESTION BELGIANS CONCERNING THE SCOPE FOR INTRODUCING SELECTIVE MEASURES TO REVERSE DECLINE IN PRIVATE INVESTMENT; (D) HOUSEHOLD SECTOR IS EXTREMELY LIQUID AND ACCORDING TO SECRETARIAT THIS SITUATION CONTAINS SIGNIFICANT INFLATIONARY POTENTIAL. MISSION PLANS TO ASK IF BELGIANS WOULD AGREE WITH SECRETARIAT VIEW.
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